

**OPENING STATEMENT OF CHAIRMAN PAUL E. KANJORSKI  
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND  
GOVERNMENT SPONSORED ENTERPRISES**

**HEARING ON THE EFFECTIVE REGULATION OF THE  
OVER-THE-COUNTER DERIVATIVES MARKETS**

**JUNE 9, 2009**

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Today, we meet to consider another area of our capital markets woefully lacking in effective regulatory oversight: over-the-counter derivatives. Within less than three decades, over-the-counter derivatives have become a staggering \$500 trillion market, in notional value. This market also has the potential to cause considerable harm. Last year, AIG infamously came crashing down because its lightly regulated Financial Products unit engaged in credit default swaps in the over-the-counter markets without holding sufficient capital to hedge the risks.

Since at least 1994, I have advocated for increased regulation of our derivatives markets. That year, I helped to introduce the Derivatives Safety and Soundness Supervision Act, which sought to enhance the supervision of the derivatives activities of financial institutions. In the years since then, I have backed other bills aimed at improving transparency in and enhancing the oversight of our derivatives markets.

While it has taken longer than I would have liked, I am pleased that we are now finally beginning to approach a consensus on these matters. The ongoing financial crisis has made it apparent to nearly everyone that we must move the over-the-counter derivatives market from one that takes place under the table to one that happens out in the open. In short, the time for common-sense regulation of this vast industry has arrived.

In a letter to Congress last month, the Treasury Secretary outlined his regulatory proposals for increasing transparency and efficiency in the derivatives markets, reducing risk to the overall financial system, and preventing market manipulation. I look forward to seeing the Administration's legislative language fleshing out its general principles in the very near future.

While the Agriculture Committee has shown considerable interest in this field, it is also important that our panel educate itself and act on these matters. The Administration's outline recognizes this reality. Together, I believe that both committees can take action to implement the broad concepts contained in the Treasury Secretary's plan. Moreover, we ought to move swiftly, yet deliberately, on these matters in order to improve flagging investor confidence.

As we move forward, we should remember that derivatives contracts are highly varied. Importantly, certain derivatives take the form of customized contracts that non-financial businesses employ to manage risk. By most estimates, more than 90 percent of Fortune 500 companies use over-the-counter derivatives, as do thousands of smaller businesses.

Clearly, some of these customized contracts cannot easily fit within a mandatory clearing or exchange trading regime. We therefore must find a delicate balance. Subjecting all contracts to mandatory exchange trading may cast too wide a net. Yet the clearing of most products – not all – through a central clearing entity seems appropriate and should not impose an undue burden on the affected parties. However, carving out too many exemptions as we tackle regulatory reform could create widespread economic harm in the long term.

At the same time, we cannot avoid the realization that products with unique features may require different treatment under whatever regulatory structure becomes adopted. On this point, I believe that the standardization of contracts where possible will promote smoother clearing. And clearing both opens a window through which regulators and market participants can keep a closer eye on this dark corner of the market and reduces the risks posed through the contracts collectively. The debate about the extent to which clearing becomes required is of particular importance today.

Even where clearing of contracts proves unfeasible, transparency can still exist. By mandating the collection of relevant data in a repository, we can help to ensure that regulators maintain access to useful trading information and perhaps detect warning signs of systemically risky transactions. Electronic trading also increases transparency. Further, electronic execution streamlines trading, minimizes mistakes, and enhances monitoring of the over-the-counter derivatives markets.

In sum, we have assembled a number of parties interested in and affected by the actions Congress will take in the months ahead. As we consider legislation to regulate in this field, their testimony can help guide us toward achieving the appropriate balance as we impose a sense of order in what until now has truly been the Wild West of the financial services world.

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